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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 848

WILLIAM F. WARD AND CARRIE DUFFY WARD,
Petitioners,

—v.—

THE UNITED STATES OF AMERICA,
Respondent.

KENNEDY W. WARD AND AUDREY P. WARD,
Petitioners,

—v.—

THE UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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THE UNITED STATES COURT OF CLAIMS

Petitioners-Taxpayers pray that a Writ of Certiorari issue to review the judgment of the United States Court of Claims entered in the above entitled cases on July 15, 1970.

INDEX

	Page
OPINION BELOW	2
JURISDICTION	2
QUESTION PRESENTED FOR REVIEW	2
STATUTES INVOLVED	3
STATEMENT OF THE CASE	5
REASONS FOR GRANTING THE WRIT:	
I. JUDGE COLLINS OF THE COURT OF CLAIMS IN HIS CONCURRING OPINION GAVE THE PRIME REASON FOR GRANTING THIS WRIT WHEN HE STATED: "Justice demands that our laws provide a means of relief for persons, like plaintiff, who sustain such a casualty loss." THE INTERPRETATION AS PLACED ON THE APPLICABLE PROVISIONS OF THE INTERNAL REVENUE CODE BY THE COURT OF CLAIMS IS IN CONFLICT WITH THE ORIGINAL INTENT OF CONGRESS IN ALLOWING CASUALTY LOSS AS A LEGISLATIVE GRACE.	6
A. General Statement	7
B. Legislative History	11
C. Court Decisions	19
II. IT IS IN THE INTEREST OF THE GENERAL PUBLIC TO CLARIFY THE	

Page

LAW ON THIS SUBJECT, FOR IT IS DECLARED PUBLIC POLICY OF THE UNITED STATES TO ENCOURAGE AND PROTECT THE GROWTH OF TIMBER, ONE OF OUR NATURAL RESOURCES..... 22

CONCLUSION..... 24

APPENDIX

Opinion of the United States Court of Claims..... 1a

TABLE OF CITATIONS

Page

Cases:

Helvering v. Owens, 305 U. S. 468..... 19
Rosenthal v. Commissioner, 416 F.2d 491. 20
Watson Industries v. Shaw, 235 N. C. 203 (1952)..... 9

Internal Revenue Code of 1954: (Chapter 736 - Public Law 591)

Section 165 appears as Title 26 USCA 165, as of 1963..... 3
Section 1011 appears as Title 26 USCA 1011..... 4
Section 1012 appears as Title 26 USCA 1012..... 4
Technical Amendment Act of 1958..... 21

Congressional Documents:

Congressional Record of 1918, Page 10539. 11
H. R. 2762, a bill "To Consolidate and Codify the Internal Revenue Laws of the United States" which became the

Page

Revenue Code of 1939. Congressional Record, Volume 84, 1 and 11 for the 76th Congress, 1st session..... 11 et seq

Miscellaneous:

Forest Valuation, H. Chapman and W. Meyer (1947)..... 21

Popular Government, published by the Institute of Government, University of North Carolina, Chapel Hill, October 1968, article entitled, "The Forest Landowner and North Carolina Law", by Keith A. Argow..... 22

OPINION BELOW

The Opinion, Findings of Fact and Conclusion of law of the United States Court of Claims, decided July 15, 1970, is reported at 428 F.2d 1288 (Ct. Cl. 1970), and is printed in the Appendix to this Petition.

JURISDICTION

Jurisdiction of this Court is invoked under 28 U.S.C. Section 1255 (1).

QUESTION PRESENTED FOR REVIEW

WHAT IS THE FEDERAL LAW REGARDING CASUALTY LOSSES FOR DESTROYED TIMBER THAT CAN NEVER ACQUIRE A COST BASIS?

OR

ARE THE PLAINTIFFS-TAXPAYERS ENTITLED TO TAKE AS A DEDUCTION ON THEIR FEDERAL INCOME TAX RETURN, UNDER THE INTERNAL REVENUE CODE OF 1954, SECTION 165(a) AND (c) FOR THE TAX YEAR 1963, AS A FIRE "LOSS SUSTAINED DURING THE TAXABLE YEAR AND NOT COMPENSATED FOR BY INSURANCE OR OTHERWISE", THE ACTUAL VALUE OF TIMBER DESTROYED WHICH GREW AND CAME INTO EXISTENCE AFTER THE DATE OF THE PURCHASE OF THE REAL PROPERTY ON WHICH IT STOOD AT THE TIME OF THE FIRE, AND WHICH HAD NO COST BASIS SINCE NONE OF THE ORIGINAL PURCHASE PRICE OF THE LAND COULD BE ATTRIBUTED TO TIMBER WHICH DID NOT EXIST AT THE TIME OF THE PURCHASE OF THE LAND, OR IS SUCH A DEDUCTION FOR TIMBER DESTROYED BY FIRE, UNDER SECTIONS 165(b), 1011 AND 1012 PROHIBITED AS BEING AN "OTHER DISPOSITION OF PROPERTY" WHICH IS NOT DEDUCTIBLE, IN THE ABSENCE OF A COST BASIS, ALTHOUGH DUE TO THE PECULIAR NATURE OF THIS TIMBER, IT COULD NEVER HAVE A COST BASIS?

STATUTORY PROVISIONS INVOLVED

The following sections of the Internal Revenue Code of 1954 as the same existed in 1963 are applicable:

"Section 165. Losses.

"(a) General Rule.--There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise."

"(b) Amount of deduction.--For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property."

"(c) Limitation on losses of individuals.--In the case of an individual, the deduction under subsection (a) shall be limited to--

(1) losses incurred in a trade or business;
(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business;
(3) losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck or other casualty, or from theft. No loss described in this paragraph shall be allowed if, at the time of the filing of the return such loss had been claimed for estate tax purposes in the estate tax return."

"(d). . .

"Section 1011. Adjusted basis for determining gain or loss.

The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under section 1012 or other applicable sections of this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses)), adjusted as provided in section 1016."

"Section 1012. Basis of property--Cost.

The basis of property shall be the cost of such property, except as otherwise provided in this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses). The cost of real property shall not include any amount in respect of real property taxes which are treated under section 164(d) as imposed on the taxpayer."

STATEMENT OF FACTS

During the calendar year 1963, the plaintiffs, William F. Ward and Kennedy W. Ward, each owned a one-half undivided interest in a tract of land consisting of 2,672 acres, more or less, located in Craven County, North Carolina. At the time the plaintiffs acquired this land, it had been burned over many times, and it had very little timber growing on it. After the purchase of the real property, the plaintiffs protected the same from fire, and the amount of timber increased substantially by natural growth and in addition, the plaintiffs had improved the timber stand by planting pine seedlings. As a result of this, by 1963, they had a good growth of timber on this property. Since this timber did not exist at the time the plaintiffs purchased their interest in the real property, the timber which was grown had no cost basis and never could have any, for no portion of the purchase price for the naked tract could be attributed to timber that did not exist at the time of the purchase. In April 1963, a fire burned over most of said tract, destroying the trees and timber growing thereon. The fair market value of each of the plaintiffs' one-half interest in the timber immediately prior to the fire was $34,097.02, and the fair market value of the one-half interest of each of the plaintiffs in the timber immediately after the fire loss was $6,067.96, and that the fair market value of the one-half interest of each of the plaintiffs of the timber destroyed by fire was $28,029.06. In filing their Federal Income Tax Return for 1963, William F. Ward and Kennedy W. Ward each took as a deduction, a casualty loss of $28,029.06. That subsequently, the Internal Revenue Service disallowed the deductions and assessed against William F. Ward and wife, Carrie D. Ward, the sum of $1,969.25, including interest and penalties, which was fully paid. That Kennedy W. Ward and wife, Audrey P. Ward, were assessed a total

amount of $3,317.28, which included interest and penalties, which was also fully paid.

Plaintiffs subsequently filed timely claims for refund which were disallowed, and the petitions to the Court of Claims were based upon the action of the Internal Revenue Service.

Plaintiffs claimed that, under Sections 165(a) and (c) of the Internal Revenue Code of 1954, they can avail themselves of the claimed deductions as a casualty loss of property not held in connection with a trade or business, consisting of the timber destroyed by fire when such loss was not compensated by insurance or otherwise.

Petitioners' position is that under Section 165, the entire 1963 fire loss of their timber, which was not connected with their trade or business, may be deducted and maintain that in 1963 they suffered an actual combined tangible loss of $56,058.13 in the market value of their pine timber. They contend that the purpose and intent of Congress was to allow deductions for such an actual loss.

The Court of Claims denied the Petitioners' claim for refund and upheld the Internal Revenue in its disallowance of the casualty claim by the Petitioners for the timber that was destroyed.

REASONS FOR GRANTING THE WRIT

I.

Judge Collins of the Court of Claims, in his concurring opinion, gave the prime reason for granting this Writ when he stated:

> "Justice demands that our laws provide a means of relief for persons, like plain-

tiff, who sustain such a casualty loss."

The interpretation as placed on the applicable provisions of the Internal Revenue Code by the Court of Claims is in conflict with the original intent of Congress in allowing casualty loss as a legislative grace.

A.

GENERAL STATEMENT

The Court of Claims in its decision, squarely faced the issue as raised hereinabove of "What is the Federal Law regarding Casualty Losses for destroyed timber that can never acquire a cost basis?", and ruled against the Taxpayers-Petitioners and found that timber, as involved here, which could never acquire a cost basis, and when destroyed could never be deductible as a casualty loss.

Judge Collins, in his concern for taxpayers faced with the present situation, believing that the Court of Claims would be legislating to allow such deductions, while concurring in the opinion, made his views clearly understood when he stated as follows:

> "Under the existing provisions of the Internal Revenue Code, there is no alternative but to concur in the result reached in this case. However, since this court cannot legislate, the need here is for Congress to change the existing law in regard to timber losses.
>
> "This case is a perfect example of how easy it is for an individual, owning farm land or uncultivated land on which there has developed a natural growth of timber, to

> sustain a loss of considerable value as the result of fire or other casualty. The fact that this loss is nondeductible is due mainly to the fact that timber, unlike so many other commodities, can develop naturally without any human assistance, thus never incurring a cost basis. Justice demands that our laws provide a means of relief for persons, like plaintiff, who sustain such a casualty loss." (428 F2d 1288)

The Court of Claims reluctantly concluded that naturally grown timber as involved here, although with a considerable market value, but with no cost basis, was not deductible as a casualty loss. This results in writing in an exception to Section 165 of the Internal Revenue Code, thereby expressly limiting the legislative grace granted by Congress to all taxpayers who have suffered a loss, not compensated by insurance or otherwise, involving all types of property, with the exception of taxpayers, as the Petitioners here, and timber naturally grown.

In all fairness to the Court of Claims, it appears that the Court felt that to allow such deductions would be getting into Congress' domain. On the contrary, its decision limits the general purpose and intent of Section 165(a) and qualifies the same when there were no qualifications originally placed therein as to any specific type of property.

Looking at Section 165(a) of the Internal Revenue Code, the language is not complicated nor involved. Paraphrasing only slightly, it says: Losses of property not connected with a trade or business sustained in the income year, if arising from fire, storm, shipwreck, or other casualties or theft, shall be allowed as deductions to the extent such losses are not compensated for by insurance or otherwise. In other

words, the entire loss may be deducted unless it is minimized by some recovery.

The Courts have generally held, including those in North Carolina, that "In the interpretation of statutes levying taxes, it is the established rule not to extend their provisions, by implication, beyong the clear import of the language used, or to enlarge the operation so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government, and in favor of the citizen." Watson Industries v. Shaw, Commissioner of Revenue, 235 N. C. 203 (1952)

However, the Internal Revenue Service says that all such deductions are subject to subsection (b) of Section 165, and Section 1011 and 1012 which says that only items that have a cost basis which are destroyed, may be deducted. The logic behind this interpretation for most items which might fall in this category, is very clear in that when you have stock, automobiles, boats, airplanes and various other tangible objects that have, either by obsolescence, or depreciation or wearing away, lost their value, an individual should not be allowed to deduct the original purchase price which the item no longer has full original value, that has been destroyed. Here, the rule should not apply to timber, for if the interpretation placed on such a deduction, as claimed by the plaintiffs, is in fact the law of the United States, then the natural reseeding and the resulting timber grown on real property after the date of the purchase of the real property on which it grows, since no portion of it could be attributed to the original purchase price of the real property, is the one item of property that could never be claimed as a loss under these sections of the Code. To phrase it a little differently, only timber that is stand-

ing and in existence at the time of the purchase of the real property on which it is located, would ever be a deductible item under these sections of the Act, while natural timber that grew after the date of the purchase would and could never be deductible, for it would never acquire a cost basis attributed to the original purchase price.

It is fairly obvious the purpose and intent behind Congress to allow deductions for such losses. It is a grace given to the taxpayer when he has suffered a financial loss in any tax year, to soften the burden on him, by allowing him to deduct it from his income taxes. To express it along the lines of a very famous quote, when life hands the taxpayer a lemon, Congress added a little sugar to it, so that the taxpayer could make a lemonade out of it and get some advantage! The narrow interpretation placed on timber, prohibiting a deduction in this case, and the resulting hardship, is inconsistent with economic realities. To sustain this interpretation, it must be founded on the basis that the taxpayer has suffered no actual loss! In the case at hand, the plaintiffs-taxpayers on one afternoon had standing, tangible timber, with a market value of $68,194.05. Several days later, the market value of this property was reduced to $12,135.92, and their net worth was reduced by $56,058.13. There was an actual tangible loss suffered by the taxpayers, and not just a paper loss. It was argued by the Internal Revenue Service that there is no difference in a taxpayer who buys a building which increases in value, and a taxpayer buying naked land on which ultimately trees are grown. In the case of the building, the taxpayer still has the original building. In the case of the land, no trees were in existence, and now there exists something that did not exist at the time of the purchase of the real property, which has

a distinct separate tangible existence and value to the taxpayers.

B.

LEGISLATIVE HISTORY

A review of the Revenue Act beginning with the 16th Amendment to the Constitution on March 1, 1913 to 1963, finds the word "timber" mentioned only a very few times. After the 16th Amendment was passed, the Revenue Acts of 1916 and 1917 were enacted. In 1918, in response to the War effort, House Bill H. R. 12863 was introduced and ultimately became the Revenue Act of 1918. The debates on this bill are most comprehensive, covering almost every conceivable argument, in regard to taxes, but contained only one reference to timber. Congressman Claude Kitchen, Chairman of the Ways and Means Committee, apparently as an afterthought, since the bill was almost through the House, amended the proposed Act by the addition of the word "timber" in order to give it the same status given to mines, minerals, oil, etc. Congressional Record, 1918 page 10539. (Of interest to the petitioners in regard to this bill, is that Senator F. M. Simmons of North Carolina was Chairman of the Finance Committee which handled it, and the Senator was at one time associated in a law firm with the petitioner, William F. Ward.)

There appears to be no legislative history on timber applicable to the subject at hand, other than a directive to the Court, which is reflected in the debate on adopting the 1939 Revenue Code, and which is set out in detail hereinafter. In addition, favorable treatment was given timber by Congress in the Technical Amendments Act of 1958 referred to hereinafter. The 1939 Revenue Act was the first codification of all of the Internal Revenue Laws of the United States up

until the date. Examination of the Revenue Act of 1939, reflects that Sections 23 (i) and 113 (a) and (b) are substantially the same as Sections 165, 1011 and 1012 of the Internal Code for 1954. Similar language is found in the various Revenue Acts from 1921 through 1938. The Internal Revenue Code of 1939, and its legislative history is of significance for, for the first time, there is a consolidation and codification of all the Internal Revenue Laws of the United States. This piece of legislation is the parent, or the foundation for the Internal Revenue Code of 1954, and where we should look for legislative intent! Examination of the history of the 1939 Act reflects that H. R. 2762 was a bill entitled "To Consolidate and Codify the Internal Revenue Laws of the United States", and was 500 pages long. It was introduced by Congressman Robert Dalton of North Carolina, Chairman of the Ways and Means Committee on January 18, 1939. It went through Congress and was signed into law in 23 days as follows:

1. January 23, 1939 -- Debated briefly in House.

2. January 25, 1939 -- Debated extensively in House and passed.

3. January 27, 1939 -- Introduced into Senate and referred to Finance Committee.

4. February 1, 1939 -- Reported to Senate.

5. February 2, 1939 -- Passed Senate.

6. February 3, 1939 -- Presented to President.

7. February 10, 1939 -- Enacted into law.

76th Congress, 1st Session, Volume 84 Congressional Record, I & II. A close review of the debates surrounding this particular legislation reflects that the members of Congress never read the Revenue Code of 1939 before it was passed, and that various members of the Congress stated for the future that it would expect the Court to consider the various aspects of the legislation and to correct them when they came up, since Congress never really focused its attention on the same.

The following is also taken from the 76th Congress, First Session, Congressional Record, Volume 84, parts I and II. It is necessary to use this source for the legislative history, for their appear to be no printed hearings on H. R. 2762 in the House. The first reading of the 500 page bill was waived at page 646 of the Congressional Record, and then the following transpired:

> Mr. Doulton: "Mr. Speaker, the bill under consideration, H. R. 2762, consolidates and codified the Internal Revenue laws of the U. S., and would enact into absolute law instead of prima facie evidence of law all of the internal revenue laws that are now in force."
>
> "...It brings into consolidated form, into one compact volume, about 150 separate acts of Congress, beginning with the revised Statutes, enacted in 1874..."
>
> "...this bill makes no change whatever in existing law, but consolidates and codifies the existing law, and brings it all into one volume so that it is immediately and conveniently available.

(at page 782-784) Congressman Gifford wanted to know if taxpayer interest protected since a bill by Treasury Department. Says Codified but believes in favor of Government since on State committee lots of liberties taken.

(at page 784) Congressman Jesse P. Wolcott (Michigan) said: "That there are opportunities in the codification of laws for endless litigation." (em. added.)

(continuing)..."In this bill emphasis has been placed on certain provisions of the revenue laws. I think we must bear in mind that this bill is not only prima facie evidence of the law, but is the law itself. In the case of any error on the part of the Government Printing Office in printing a copy of the act, that copy is the law regardless of anything, to the contrary. Now, that is not good legislation. It is not good legislation to tie the hands of our courts so that they have to take a copy of an act printed by the Government Printing Office as absolute proof of law. That is a denial to the judicial branch of our Government of the right to go behind the law and to determine legislative intent."

(at page 786) Mr. Michener continued: "I have not read this bill. No one else has, except maybe one or two members of the Committee on Ways and Means, and I doubt if the chairman of that committee himself has read this entire bill through. I doubt if any other member of the committee has read it through..."

(at page 786) Mr. Doulton: "If I had read it, I could only have done it hurriedly, and

I have not confidence in my own reading that I have in the reading and re-reading done by the staff a dozen times, and the checking of this bill by the experts of the Treasury Department and the Department of Justice. Neither has the gentlemen." (Emp. Added)

(at page 787) Mr. Michener: "The gentlemen concede that no one has read the bill. I have the utmost confidence in and respect for the chairman, but why cannot we be given a few days to at least casually examine the bill? Possibly all will not read all of the bill, but some will give it study."...

"We have gone since 1874, the gentleman from Massachusetts tells us, without rewriting this law, and then it is brought before the House and we are asked to pass a new tax law without reading it, and by unanimous consent. Of course, objection was made to passing this law by unanimous consent without reading it and withoug knowing what is in it. So today the matter is called up without notice and we come in here to discuss this matter which is of vital importance to every taxpayer in the country, and we are asked in the name of the taxpayer to pass the bill."

"Now, listen. It seems to me the American people have reached a stage where they want this Congress to proceed cautiously and carefully. In matters of this kind haste makes waste. If the American people even gave the Congress a mandate, it is that we must know what we are doing, that we must not pass laws that we know nothing about, regardless of the recommendation of somebody down in the Treasury Department, in the Labor Department, or in any other department of the Government."

"I stand squarely on the premise that this Congress itself, through its own agencies, should know what it is considering and should vote intelligently upon what is before it. I do not think it is a credit to the committee to come in here and say, No we have not read it; we do not know what is in it; we would not know what was in it if we did read it, so we left it to the committee clerk or staff. (emp. added) This is the situation we find ourselves in. You have left it to the committee clerk or staff. I hope the committee clerk is right. I am sure he has done his best. This bill is going to pass the House. It may become a law, but when these errors are found--and errors will be found--then I hope when they are found, the Congressional Record will record that some of us have risen on the floor and protested against this procedure, although we are heartily in favor of the objective. (emp. added) I hope those interpreting this law will read the statement of one gentleman of the Ways and Means Committee who says this is a men's 'compilation', that no changes have been made, that the purpose and intent was not to eliminate a word from existing law, and then I hope they will read the statement of the other Ways and Means Committee member who says it is a "Codification', that there are changes, but that nothing material has been eliminated. Nothing material has been eliminated. Who determines the materiality? Did the Congress determine whether or not the elimination of a certain phrase was material? No, we left it to the Committee Clerk or staff, if you please, and then we put our stamp of approval on it without any knowledge whatever as to the facts. This bill may be all right. I hope so. The tax laws need clarifying more than they need

codifying. I am opposed to this haste. I am opposed to this procedure." (Applause)

(Then at page 789 the Clerk started reading the bill, and the following transpired:)

Mr. Doulton: "Mr. Chairman, I ask unanimous consent to dispense with the further reading of the bill and that the bill be not printed in the Record, as I understand it would cost between $14,000.00 and $15,000.00 to print it, and copies of the bill will be available to every member of the House."

Mr. Michener: "Reserving the right to object, Mr. Chairman, this is the second reading, or, really, the first time the bill is to be read, and there will be no further reading of the bill?"

Mr. Doulton: "Yes, the gentleman is correct."

Mr. Michener: "I shall not object, but I do want to call the gentleman's attention to the fact that we are passing this bill without even having it read..." (emp. added)

In the Senate, after the bill passed the House on January 25, 1939, it was introduced on January 27, 1939, as appears at page 891 of the Congressional Record and sent to the Finance Committee. It was reported to the Senate on February 1, 1939, three days later, Senate Report No. 28, which throws no light on the current subject. This action appears at page 991 of the Congressional Record. There is only one page of argument that appears in the Congressional Record for the Senate at page 1056 on February 2, 1939, when it was passed into law, which is, in part, as follows:

"Mr. George: "The Code make no change in existing law..."

"Mr. President, I might say that it is of the utmost importance, as the Joint Committee on Internal Revenue Taxation, the Department of Justice, and the Treasury concurs, that the Code be adopted as absolute law and the enacting clause makes it so. There can be no serious dangers of omission or material change in the existing law arising through mistake or inadvertence, because we deal constantly with the Internal Revenue laws. As every Senator knows, we pass a tax act practically every year, and any mistakes can be readily discovered and corrected. It will, of course, permit a new point of departure for the convenience of the Courts, and the Congress itself in enacting new Revenue acts."

The law was then presented to the President on February 3, 1939, and signed on February 10, 1939, and enacted all within 23 days.

A review of the above quotations reflects that no consideration of any sort was given to the Revenue Act of 1939, and in fact, it was never read in the House of Representatives. The comments of Mr. Michener reflect that he wanted the Court to know that the members of Congress did not want what was in it, and in substance, would have to correct any defects that were made by Congress in passing this legislation. A very similar thought is expressed in the above quote from Mr. George in the Senate, when he stated, "It will, of course, permit a new point of departure for the convenience of the Court." It appears that both hereinabove, the 1954 Revenue sections of the Code, with which we are concerned, are practically the same as the 1939 Act. Apparently there is no expression of any intent on the part of Congress in regard to this particular subject of timber under consideration here other than it would be up to the courts to cor-

rect any errors.

C.

COURT DECISIONS

The case of Helvering v. Owens, 305 U. S. 468 (1939), is the leading case on casualty losses and has been cited as the authority of the Government, as well as the Court of Claims, for disallowing the Petitioners' casualty loss. This case was heard in the Supreme Court in 1939, prior to the adoption of the Revenue Act of that year. This case concerned two taxpayers who had sufferred losses as a result of non-business property being destroyed. In one instance, an automobile was involved, and in another instance, a boat, boathouse and dock was involved. According to the Government's brief in the Court of Claims, this case set forth the following rule:

> "It held that the deduction for a non-business loss cannot exceed the cost of the property or, where the cost basis has been adjusted, it cannot exceed the adjusted basis, and where the economic loss is less than the adjusted basis, it cannot exceed such loss."

A review of this decision fails to substantiate the above quote for the case appeared to go off on the question of depreciation for the Court stated:

> "And as the property involved was subject to depreciation and of less value in the taxable year, than its original cost, we think Section 113 (b) (1) (B) must be read as limitation upon the amount of deduction so that it may not exceed cost, and in the case of depreciable non-business property, may not exceed the amount of the loss

actually sustained in the taxable year, measured by the then depreciated value of the property. The treasury rulings have not been consistent, but this construction is the one which has finally been adopted."

For this reason, the Helvering v. Owens case does not appear to be controlling in the current situation. Taking the language quoted first hereinabove from the Government's brief, if in fact it was the law, "the deduction for a non-business loss cannot exceed the cost of the property", WHAT IS THE RULE WHEN THE PROPERTY, TIMBER, HAD NO COST? If "where the cost basis has been adjusted, it cannot exceed the adjusted basis,..."WHAT IS THE RULE WHEN THE PROPERTY, TIMBER, HAD NO COST TO BE ADJUSTED? And last, "where the economic loss is less than the adjusted basis, it cannot exceed such loss", WHAT IS THE RULE WHEN THE PROPERTY, TIMBER, HAD NO ADJUSTED BASIS?

There is no case directly on point on this subject. The decision of the Court of Claims is the first filing squarely on this subject of timber. However, there is language worthy of note in Rosenthal v. Commissioner, 416 F. 2d 491, in Judge Moore's dissent at page 501, a case involving timber descroyed by an ice storm. This also points out additional Congressional intent for preferential treatment of timber and the resulting hardships to the taxpayer in the absence of allowing him the legislative grace given by Congress. Judge Moore said:

"Finally, the purposes of the casualty loss provision in the Code, is to permit deductions for uncompensated loss. Timber is perhaps a classic case for application of this provision. Insurance against losses to standing timber from ice, fire, windstorm or other casualty is generally unavailable in the United States. Each

> timber owner is forced to bear the full brunt of such loss. See H. Chapman and W. Meyer, Forest Valuation, 349-54 (1947). If timber owners are not permitted deduction for loss to immature growth, then they must bear the decrease in value of their property, without any effective offset. Yet Congress expressed its intention that casualty losses be allowed as a deduction against ordinary income to the fully extent of loss. Consistent with this view, Congress determined in the 1958 Amendment to Section 1231, that the deduction for casualty loss was not to be reduced or minimized by reason that timber was entitled to capital gain treatment as Section 1231 property."

Judge Moore was referring to Technical Amendments Act of 1958 and to Senate Report 1983, 85th Congress, First Session, Pages 74 and 203, I believe.

This is tangible evidence of Congress' intent to give preferential treatment to timber and timber growers. The decision of the Court of Claims not only qualifies Congressional intent regarding timber, but in fact discriminates against the timber grower in this type of case, by denying to him the benefits of Section 165 (a).

The Rosenthal case is distinguished from the present case, in that in 1960, the taxpayers involved therein bought a tract of timber in Tennessee. A portion of the purchase price was attributed to the land, and a portion to the timber standing thereon. On the 2nd day of March of that same year, approximately three months later, a large portion of the property was destroyed by an ice storm. In that case there was a cost basis in the timber, and the only question was how the loss should be treated.

11.

It is in the interest of the general public to clarify the law on this subject, for it is the declared public policy of the United States to encourage and protect the growth of timber, one of our natural resources.

In the home state of the petitioners-taxpayers, there are more small timber growers than in any other state in the Union. "Popular Government", published by the Institute of Government, University of North Carolina, Chapel Hill, October 1968, "The Forest Landowner and North Carolina Law", by Keith A. Argow. "Over the years, the North Carolina General Assembly has enacted a number of General Statutes and Regulations concerning forestry. The earliest dates back to 1777, when intentional woods-burning was declared illegal and punishable by a fine or 39 lashes 'well laid on" a "bare back". (Laws of 1777, November, Chapter 25.) More recently from a review of our legislation, "It is declared policy of North Carolina to use real estate taxation so as to 'encourage conservation of natural resources...'".

This is true not only in North Carolina, but also on a national level, for our woodlands are part of our greatest wealth and many steps have been taken on the federal level to protect them, and in fact, it has become public policy to protect and encourage the growth of timber. One example is Smokey the Bear! Accordingly, because of the pecularities which are an inescapable part of raising trees, there is presented a special case in regard to a small timber grower that must be treated accordingly, so far as taxation is concerned. Without the small forest landowner, it would not be long until our forest resources were exhausted, which would be a national tragedy of the first dimension. But, growing timber has

unique attributes. Depending on the variety and location, it takes twenty, fifty, one hundred or even more years for trees to grow to marketable size. During all this time, the landowner must keep the trees protected from such enemies as insects, fire and disease. In devoting such large amounts of time to this endeavor, the landowner must see a chance of a fair profit when he does market his timber, and he must know that in the event of fire that it is not an entire loss.

The construction as applied by the Internal Revenue Service and the Court of Claims is against this public policy of encouraging the growth of timber, for it demoralizes the small landowner and timber grower. If generally known, who would want to engage in such a hazardour investment of his time and energies that could be a total loss over night? "Many a small landowner has a deep dread of fire, and properly so, for it can wipe out a lifetime investment in one blazing afternoon." Popular Government, supra.

If the tax laws are as interpreted by the Internal Revenue Service, and the Court of Claims, every property owner that has any timber that has grown on land after the date of purchase, should immediately cut the same, unless he is willing to gamble that he will be able to protect it from loss and get more for it later. If he gambles, and it is destroyed by fire, or other casualty, then under the present interpretation, it would be said that he suffered no loss and was entitled to no tax benefit, although he had something that he could turn into cash, if he sells it immediately before such loss. This should not be the law.

The Government's attorney in the Court of Claims argued that property of all kinds often increase in value, and that timber, as here, should not be given preferential treatment. During the oral arguments the Government's attorney acknowledged to the Court that she knew of no

other type of property that reproduced itself at no cost to its owner. Where nothing stands now of value on a naked tract of land, in 25 years there may be a very valuable stand of timber with a considerable market value.

Congress through its many efforts to preserve our natural resources, and its preferential treatment of the same, has indicated an intention to encourage protection of all of our natural resources, including timber. The treatment in the Technical Amendments Act of 1958, whereby Congress expressed its intention to allow casualty losses as a deduction against ordinary income to the full extent of the loss, is tangible proof of the preferential treatment intended for timber. Certainly, Congress did not intend to place limitations or restrictions on the casualty loss provisions of Section 165(a) of the Internal Revenue Code, with the resulting hardship imposed only on timber.

CONCLUSION

It is inconsistent with economic reality, and an injustice to the plaintiffs who sustained a loss in the manner described, to prohibit any loss deduction since the timber did not exist at the time of the purchase of the land on which it had grown, and no portion of the purchase price of the original property could be attributed to its cost basis. A correct result requires that Section 165 (a) and (b) and (c) be interpreted to permit fair market value as the deduction in the specific case of losses of timber as in the present instance, with the realization that Congress would not have permitted such an inquitable result as has developed here. One alternate approach for attaining the same result, is to interpret Section 1016 (a) (1) of the Internal Revenue Code of 1954, which provides for an upward adjustment in the basis of property to

reflect receipts and other items properly chargeable to the capital account, to recognize as a justifiable capital charge, the increased value of growing timber.

The petitioners-taxpayers here had a valuable property, for through normal growth and planting where one tree had stood, many were standing. Their value contributed substantially to their net worth, and their destruction by fire reduced in "one blazing afternoon", their net worth by $56,058.13, or $28,029.06 for each of the taxpayers, William F. Ward and Kennedy W. Ward, and resulted in a very real, very substantial monetary loss to them for the timber immediately before the fire, at an actual market value which was almost wiped out by the holocaust. This was no mere paper loss, and the petitioners-should be allowed to deduct such loss from their income tax returns for the year 1963, and to recover the additional tax assessed, along with the interest and penalties.

For the foregoing reasons, it is respectfully submitted that the Petition for Certiorari should be granted.

Respectfully submitted,

Kennedy W. Ward

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28560

OPINION, FINDINGS OF FACT, AND CONCLUSIONS OF LAW

In the United States Court of Claims

(Decided July 15, 1970)
(Reported at 428 F. 2d 1288)

No. 300–68

WILLIAM F. WARD AND CARRIE DUFFY WARD v. THE UNITED STATES

No. 301–68

KENNEDY W. WARD AND AUDREY P. WARD v. THE UNITED STATES

Kennedy W. Ward, attorney of record, for plaintiffs. *Ward & Ward*, of counsel.

Frances M. Foltz, with whom was *Assistant Attorney General Johnnie M. Walters*, for defendant. *Philip R. Miller*, of counsel.

Before COWEN, *Chief Judge*, LARAMORE, DURFEE, DAVIS, COLLINS, SKELTON and NICHOLS, *Judges*.

OPINION

DURFEE, *Judge*, delivered the opinion of the court:

This is an action for refund of Federal income taxes, with interest, assessed and collected from plaintiffs by defendant. The case comes before the court on a Memorandum Report by Trial Commissioner Franklin M. Stone, without findings, upon facts stipulated by the parties.

On April 4th and 5th, 1963, a fire burned over almost an entire tract of 2,672 acres of pine timber land. Plaintiffs in each of these two actions owned a 50 percent interest in this

property acquired by a total purchase price of $8,045, and 50 percent of the loss is attributable to each of the two parties plaintiff.

The amount of timber had increased substantially by natural growth during the ownership of plaintiffs, who had also, in addition, improved the timber stand by planting pine seedlings at small cost. Plaintiffs had conducted sporadic pulpwood and logging operations during the years preceding the casualty, and taxpayers' tax basis in the tract had been further reduced to zero by losses from other fires before 1963.

The fair market value of the damaged and destroyed timber was $56,058.13, the fair market value of the remaining timber was $12,135.92, and plaintiffs salvaged and sold damaged pine which produced $5,291.44 in income during 1963–1965. Each of the two parties plaintiff deducted a casualty loss of $28,029.06 in their 1963 U.S. Income Tax Return, for growing trees destroyed by fire and resulting insect infestation. The Internal Revenue Service disallowed these deductions, and assessed deficiencies, penalties and interest thereon which were paid in full. Plaintiffs subsequently filed timely claims for refund which were disallowed, and the petitions herein are based upon this action by the Internal Revenue Service.

Plaintiffs claim that, under §§ 165(a) and (c) of the Internal Revenue Code of 1954, they can avail themselves of the claimed deductions as a casualty loss of property not held in connection with a trade or business, consisting of the timber destroyed by fire when such loss was not compensated by insurance or otherwise. Plaintiffs also submit, in the alternative, that the loss of this timber by fire was not a "sale or other disposition of property" under § 165(b) of the Code.[1]

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[1] The relevant sections of the Internal Revenue Code of 1954 provide as follows:

"SEC. 165. LOSSES.

"(a) General Rule.—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

"(b) Amount of Deduction.—For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted

Section 165(b) provides that "the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 * * *." Section 1011 then provides that the basis for determining gain or loss "shall be the basis (determined under section 1012 * * *), * * * adjusted as provided in section 1016." To the extent pertinent here, § 1012 provides that the basis of property shall be its cost, and § 1016, in turn, provides for adjustments to the cost basis to reflect further events affecting the capital account of the property.

The cost basis of plaintiffs' timber land, under § 1012, was its purchase price. Adjustments to this basis are made under § 1016(a)(1) for "expenditures, receipts, losses or other items, properly chargeable to capital account * * *", and

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basis provided in section 1011 for determining the loss from the sale or other disposition of property.

"(c) Limitation on Losses of Individuals.—In the case of an individual, the deduction under subsection (a) shall be limited to

* * * * *

"(3) losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. No loss described in this paragraph shall be allowed if, at the time of filing the return, such loss has been claimed for estate tax purposes in the estate tax return.

* * * * *

"SEC. 1011. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

"The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under section 1012 * * *) * * *, adjusted as provided in section 1016.

"SEC. 1012. BASIS OF PROPERTY—COST.

"The basis of property shall be the cost of such property, except as otherwise provided * * *.

"SEC. 1016. ADJUSTMENTS TO BASIS.

"(a) General Rule.—Proper adjustment in respect to the property shall in all cases be made

"(1) for expenditures, receipts, losses, or other items, properly chargeable to capital account, * * *

* * * * *

"(2) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent of the amount—

"(A) allowed as deductions in computing taxable income under this subtitle or prior income tax laws, and

"(B) resulting (by reason of the deductions so allowed) in a reduction for any taxable year of the taxpayer's taxes under this subtitle (other than chapter 2, relating to tax on self-employment income), or prior income, war-profits, or excess-profits tax laws,

but not less than the amount allowable under this subtitle or prior income tax laws. * * *"

* * * * *

under § 1016(a)(2) for "exhaustion, wear and tear, obsolescence, amortization and depletion, * * *."

The amount of the deduction under § 165 is dependent upon the "adjusted basis provided in section 1011." In the present case, it is stipulated that plaintiffs "*had* [*no*] *cost or tax basis remaining in the pine* at the time of the fire, which had grown since the date of purchase, and which was destroyed by the fire, based upon each taxpayer's original purchase price." [Emphasis supplied].

The general rule is that since the adjusted basis for the timber under § 1011 as of the date of the fire was zero, there can be no deduction from income under § 165.

This became more apparent in light of the Treasury Regulations on Income Tax (1954 Code). Treas. Reg. § 1.165-1(c)(1) provides:

> The amount of loss allowable as a deduction under section 165(a) *shall not exceed* the amount prescribed by § 1.1011-1 as *the adjusted basis* * * *. [Emphasis supplied]

Treas. Reg. § 1.165-7(b)(1) provides:

> * * * the amount of loss to be taken into account for purposes of section 165(a) shall be *the lesser of either*—
>
> (i) [the loss in fair market value]; or
>
> (ii) The amount of the adjusted basis prescribed in § 1.1011-1 * * *. [Emphasis supplied]
>
> * * * * *

Plaintiffs' position is that under § 165, the entire 1963 fire loss of their timber, which was not connected with their trade or business, may be deducted. Admittedly, there was no cost basis for tax purposes in the pine at the time of the fire based upon the original purchase price. However, plaintiffs pointed out that in 1963 they suffered an actual combined tangible loss of $56,058.13 from the market value of their pine timber, and that the purpose and intent of Congress was to allow deductions for such an actual loss.

Plaintiffs also rely upon the legislative history of the 1939 and 1953 Revenue sections of the Code to argue that "[a]pparently there is no expression of any intent on the part of Congress in regard to this particular subject of timber under consideration here *other than it would be up to the courts to correct any errors.*" [Emphasis supplied.]

Plaintiffs assert in support of this novel theory of judicial *correction* rather than interpretation of Acts of Congress, that "[t]here appears to be no legislative history on timber applicable to the subject at hand, *other than a directive to the Court*, which is reflected in the debate on adopting the 1939 Revenue Code * * *." [Emphasis supplied.] The only point of reference in this debate as to correction of the 1939 bill by the courts was after passage of the bill by the House of Representatives. When the bill reached the Senate, there was considerable debate as to the undue haste in passing the bill without even having it read. In the closing debate, Senator George commented, "As every Senator knows, we pass a tax act practically every year, *and any mistakes can be readily discovered and corrected*. It will, of course, permit a new point of departure for the convenience of the courts, and the Congress itself in enacting new Revenue acts." [Emphasis supplied.] 84 Cong. Rec. 1056–57 (1939). The Revenue sections of the Code thus enacted in 1939 which are relevant to the question before us were reenacted in the 1954 Code without any discovery and correction of errors by Congress. We are not disposed to accept the justification offered by one Senator for the undue haste in the 1939 enactment as expressive of any legislative intent for this court to adopt "a new point of departure" from the clear revenue provisions of the Code involved herein, especially after Congress reiterated these same provisions in the 1954 Act.

If, as plaintiffs contend, the purpose and intent of Congress in the Act to allow deductions for plaintiffs' actual fire loss over and above their 1963 adjusted cost basis of zero is "fairly obvious," then it is equally obvious that there is no need for them to also urge this court to correct any errors in the Act.

Plaintiffs state that the real issue under consideration, simply stated, is:

> What is the Federal law regarding casualty losses for destroyed timber that can never acquire a cost basis?

By this statement, which is in accord with the stipulation of no cost basis in the timber at the time of the fire in 1963, plaintiffs have squarely placed the issue before the court. The Federal law to which we have referred as relevant to

the issue is clear that a casualty loss for destroyed timber "that can never acquire a cost basis" can never be deducted from income under the pertinent revenue sections of the 1954 Code, *supra*.

The purpose of the loss deduction was not to provide for a loss of untaxed, potential income from growing timber, through its destruction by fire, as clearly stated in *Rosenthal* v. *Commissioner*, 416 F. 2d 491 at 497 (2d Cir. 1969):

> * * * the amount of the loss deduction allowable under this section is in every case limited to the lesser amount of either the decrease in market value of the property as a result of the casualty or the taxpayer's basis in the property. Manifestly, the purpose of § 165 is not to allow the taxpayer a full deduction for every loss in market value his property suffers by reason of a casualty. The permissible deduction for such loss is always limited to the taxpayer's basis, or cost, in the property damaged. And the reason for this limitation is clear. Where the taxpayer suffers a loss from a destruction of market value greater than the cost of the property to him, that excess of value destroyed represents unrealized appreciation. And he may not claim a deduction for such loss because he has never recognized or paid a tax on the gain. In the extreme case, *where the taxpayer's basis in the property damaged is zero, and its entire market value represents unrealized appreciation, he is entitled to no deduction despite the size of the loss, large as it may be.* Consequently, taxpayers' argument that the Commissioner's result, by limiting the amount of their deduction to less than the full amount of their loss, would defeat the purpose of § 165 is simply incorrect. [Emphasis supplied.]

Plaintiffs' attempt to distinguish *Rosenthal*, *supra*, and other cases cited by defendant, and referred to in this opinion, but as counter authority have cited only the dissenting opinion in *Rosenthal*, *supra*. The dissent pointed out that "* * * Congress determined in the 1958 amendment to Section 1231 that the deduction for casualty loss was not to be reduced or minimized by reason that timber was entitled to capital gain treatment as Section 1231 property." *Id.* at 512. Without comment upon the merits of the dissent in this case, we cannot consider it as applicable here. The 1958 amendment to § 1231 of the Internal Revenue Code is not persuasive as to the intent of Congress in 1953, or in the reenactment of the

Code in 1954, particularly where we note that the entire section applies only to "property used in trade or business."

The majority opinion in *Rosenthal*, *supra*, in dealing with the allocable basis of growing timber, pointed out:

> * * * If the taxpayer had planted the young trees or otherwise obtained them at some cost, then he would have a basis allocable to those trees separate from his basis in the merchantable timber. See Treas. Reg. § 1.611-3(d)(3). He would then be able to deduct his loss in the young trees to the extent of that basis or their decline in market value, whichever was less. If, on the other hand, the new growth was regeneration which had occurred at no cost to the taxpayer he would have no allocable basis, and would not be entitled to any deduction for the loss. * * * *Id.* at 498.

Plaintiffs' basis for the timber tract might have been annually reallocated on a unit basis as to the young trees planted. Defendant points out that natural growth could become subject to the annual unit reallocation when it reaches merchantable size, but in that event, taxpayers should be taxed upon the actual tangible increment in value as it accrues by growth. (However, we need not consider this hypothesis, in view of the stipulation that neither of plaintiffs had any cost or tax basis remaining in the timber which had grown from date of purchase to the time of the fire.) Plaintiffs offer as a possible alternative solution the interpretation of § 1016(a)(1) of the Code, which provides for an upward adjustment in the basis of the property to reflect receipts and other items properly chargeable to the capital account, to recognize as a justifiable capital charge, the increased value of growing timber. However, we are foreclosed in commenting upon these hypotheses by the stipulation by plaintiffs that "* * * neither had any cost or tax basis remaining in the pine at the time of the fire, which had grown since the date of purchase and which was destroyed by the fire, based upon each taxpayer's original purchase price."

In *Helvering* v. *Owens*, 305 U.S. 468, 471 (1939), the Supreme Court said that the predecessor of § 1011 "* * * must be read as a limitation upon the amount of the deduction * * *." It held that the deduction for a nonbusiness loss cannot exceed the cost of the property or, "in the case of

depreciable non-business property may not exceed the amount of loss actually sustained in the taxable year, measured by the then depreciated value of the property." *See, also, Alcoma Association* v. *United States*, 239 F. 2d 365 (5th Cir. 1956); *Carloate Industries* v. *United States*, 354 F. 2d 814 (5th Cir. 1966).

Plaintiffs' alternative argument is that a fire loss is not "a sale or other disposition of property" under § 165(b) because they did not convey or voluntarily dispose of the timber. However, § 165(b) provides that:

> * * * the basis for determining the amount of the deduction for *any loss* shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property. [Emphasis supplied.]

The words "any loss" as used in this section cannot be narrowed by construction or interpretation to apply only to "the loss from the sale or other disposition of the property"; if this construction were adopted, § 165(b) would be mere surplusage. A casualty loss need not be equated with a "sale" or "other disposition."

Plaintiffs have asked this court to issue an order expunging a Federal tax lien erroneously filed in the office of the Register of Deeds of Craven County, to which defendant answers by correctly asserting that this court has no jurisdiction to issue such an order. *United States* v. *King*, 395 U.S. 1 (1969).

For the foregoing reasons, we conclude that plaintiffs are not entitled to recover, and the petitions are dismissed.

COLLINS, *Judge*, concurring:

Under the existing provisions of the Internal Revenue Code, there is no alternative but to concur in the result reached in this case. However, since this court cannot legislate, the need here is for Congress to change the existing law in regard to timber losses.[1]

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[1] Senator Sam J. Ervin, Jr., introduced a bill relating to timber losses on January 28, 1970. It was read twice and referred to the Committee on Finance. The bill reads as follows:

"To amend the Internal Revenue Code of 1954 with respect to the amount of deduction allowable for casualty losses to timber.

"*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled*, That (a) section 165(b) of the Internal Revenue Code of 1954 (relating to amount of deduction for losses) is amended by adding at the end thereof the following new sentence: 'In the case

This case is a perfect example of how easy it is for an individual, owning farm land or uncultivated land on which there has developed a natural growth of timber, to sustain a loss of considerable value as the result of fire or other casualty. The fact that this loss is nondeductible is due mainly to the fact that timber, unlike so many other commodities, can develop naturally without any human assistance, thus never incurring a cost basis. Justice demands that our laws provide a means of relief for persons, like plaintiff, who sustain such a casualty loss.

FINDINGS OF FACT

The court, having considered the stipulation of the parties, and the briefs and arguments of counsel, makes findings of fact as follows:

1. The plaintiffs, William F. Ward and wife, Carrie Duffy Ward, and Kennedy W. Ward and wife, Audrey P. Ward, are now, and have been at all times material to this action, citizens and residents of Craven County, North Carolina. William F. Ward and Kennedy W. Ward are father and son, respectively.

2. That throughout the entire calendar year 1963, the plaintiffs, William F. Ward and Kennedy W. Ward, each owned a one-half undivided interest in a tract of land comprising 2,672 acres, more or less, located in No. 2 Township, Craven County, North Carolina; that the said William F. Ward purchased his 50% interest in the tract in 1919 and 1920, for $4,500.00; and that the said Kennedy W. Ward purchased his 50% interest in the tract in 1952 for $3,545.00.

3. A. That on April 4th and 5th, 1963, a fire burned over almost the entire tract, resulting in the destruction by the fire and resulting insect infestation of almost all of the pine, which was the predominate type of tree on the tract.

B. The said loss was appraised by Mr. William Utley, Consulting Forester, who visited the tract on April 17, 1963,

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of a loss sustained with respect to timber, arising from fire, storm, or other casualty, the amount of the deduction for such loss shall not be less than the amount by which the fair market value of the timber immediately before the casualty exceeds the fair market value of the timber immediately after the casualty.'.

"(b) The amendment made by subsection (a) shall apply to taxable years ending after the date of the enactment of this Act."

S. 3349, 91st Cong., 2d Sess. (1970).

and on two later occasions to verify his original observations. Mr. Utley determined that the total fair market value of pine immediately prior to the fire was $68,191.05, that the fair market value remaining after the fire loss was $12,135.92, and that the fair market value of the pine destroyed by the fire therefore, was $56,058.13.

C. That Mr. Utley made no deduction for salvage in determining that the fair market value of the destroyed timber was $56,058.13.

D. Fifty percent of the loss is attributable to each, William F. Ward and Kennedy W. Ward.

4. Plaintiffs, William F. Ward and wife, Carrie Duffy Ward, timely filed a U.S. Income Tax Return for the taxable year 1963, in which they reported a taxable income of $13,390.85, and deducted a casualty loss of $28,029.06 for growing trees destroyed by fire and resulting insect infestation.

5. Plaintiffs, Kennedy W. Ward and wife, Audrey P. Ward, timely filed a U.S. Income Tax Return for the taxable year 1963, in which they reported a taxable income of $16,660.46, and deducted a casualty loss of $28,029.06 for growing trees destroyed by fire and resulting insect infestation.

6. A. That the amount of timber on the tract had increased substantially by natural growth during the ownership of William F. Ward and Kennedy W. Ward, and in addition, the taxpayers had improved the timber stand by planting pine seedlings at a small cost.

B. William F. Ward, since his purchase of his interest in 1920, had, with previous owners, and then with Kennedy W. Ward, after the purchase of his interest in 1952, conducted sporadic pulpwood and logging operations during the years preceding the casualty, and both taxpayers had reported their income from the sale of such pulpwood and timber, and as of April, 1963, neither had any cost or tax basis remaining in the pine at the time of the fire, which had grown since the date of purchase and which was destroyed by the fire, based on each taxpayer's original purchase price.

C. Other fires had previously destroyed timber on the tract, the last having occurred in 1955. The subject fire of April, 1963, was far more intense and destructive than earlier fires.

7. The taxpayers, subsequent to the fire, conducted salvage operations on the damaged pine before its complete destruction by insect and disease, which produced the following income:

1963—	$3,083.02
1964—	$2,145.94
1965—	$ 62.48
Total	$5,291.44

The total salvage was attributed one-half to each of the taxpayers, and was reported as income for the years in which cut.

8. That by proper administrative procedure, the Internal Revenue Service disallowed the deductions claimed by the plaintiffs, William F. Ward and wife, Carrie Duffy Ward, and by plaintiffs, Kennedy W. Ward and wife, Audrey P. Ward, for the casualty loss claimed as a result of the fire and resulting Insect infestation, and assessed the plaintiffs, William F. Ward and wife, Carrie Duffy Ward, the sum of $1,736.38, which along with interest and penalties amounted to $1,969.25, which was paid in full on August 8, 1966; that the plaintiffs, Kennedy W. Ward and wife, Audrey P. Ward, were assessed a deficiency in the amount of $2,904.65, which along with interest and penalties amounted to $3,309.06 and was paid in full on October 28, 1966. That an additional payment in the amount of $8.22 was made thereafter to cover accrued interest, for total payments of interest and principal of $3,317.28.

9. That on Friday, October 28, 1966, the Greenville office of the Internal Revenue Service, received check of the taxpayer, Kennedy W. Ward, dated October 27, 1966, in the amount of $809.06; the check was immediately mailed to the Raleigh office where it was received on Monday, October 31, 1966; that unaware of this payment, Federal Tax Lien No. 4912 was issued out of the Raleigh, North Carolina office of the Internal Revenue Service, on October 28, 1966, and it was mailed the same day to the office of the Register of Deeds of Craven County, North Carolina, and was filed on October 31, 1966 in the office of the Register of Deeds of Craven County against the taxpayers, Kennedy W. Ward and wife, Audrey P. Ward; the same was cancelled of record on December 29, 1966.

10. Taxpayers subsequently filed timely claims for refund for the respective amounts of assessed deficiencies and interest paid by them, which claims were disallowed prior to the filing of the petitions herein.

11. Taxpayers are the respective owners of the claims upon which these actions are based, and are entitled to maintain these actions.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiffs are not entitled to recover, and the petitions are dismissed.

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 848

WILLIAM F. WARD and CARRIE D. WARD, PETITIONERS

v.

UNITED STATES OF AMERICA

KENNEDY W. WARD and AUDREY P. WARD, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (Pet. App. 1a-12a) is reported at 428 F. 2d 1288.

JURISDICTION

The judgment of the Court of Claims was entered on July 15, 1970 (Pet. App. 1a, 12a). The petition

for a writ of certiorari was filed on October 13, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Whether petitioners are entitled to a deduction for a casualty loss of property in which, at the time of such loss, they had no basis.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 165, 1011, 1012 and 1016 of the Internal Revenue Code of 1954 and Sections 1.165-1(c)(1) and 1.165-7(b)(1) of the Treasury Regulations on Income Tax (1954 Code) are set forth in the Appendix, *infra*, pp. 6-7.

STATEMENT

Petitioners William and Kennedy Ward[1] each owned an undivided one-half interest in 2,672 acres of land in Craven County, North Carolina. In April 1963, a fire burned almost the entire tract, ultimately resulting in almost total destruction of the pine timber located on the land. The decrease in fair market value of the timber resulting from the fire, less salvage, was $50,767. (Pet. App. 9a, 10a, 11a.)

During petitioners' ownership of the tract, the timber had substantially increased in amount and value through natural growth and the planting of

[1] Carrie and Audrey Ward are their respective wives and are parties hereto because joint income tax returns were filed for the year in issue.

small seedlings. Sporadic pulpwood and logging operations had been conducted on the tract in prior years, the income from which had been reported by petitioners for income tax purposes. Petitioners had no tax or cost basis remaining in the timber when the fire and resulting destruction occurred. (Pet. App. 10a.)

In their income tax returns for 1963, petitioners claimed the entire decrease in the fair market value of the timber as a deductible casualty loss under Section 165 of the Internal Revenue Code. The Commissioner disallowed the claimed deductions and assessed deficiencies totalling $5,278. (Pet. App. 11a.)

Petitioners paid the tax in dispute and, after their timely claims for refund were disallowed, brought the instant suit for refund. The Court of Claims dismissed the suit, holding (Pet. App. 6a) that "a casualty loss for destroyed timber 'that can never acquire a cost basis' can never be deducted from income under the pertinent revenue sections of the 1954 Code * * *."

ARGUMENT

The Court of Claims' decision is correct. There is no conflict or any other ground for further review.

1. Section 165 of the Code allows a deduction for a loss to property. The amount of the deduction is expressly limited by the statute (Section 165(b), Appendix, *infra*, p. 6) to the "adjusted basis provided in section 1011." Section 1011 and its related sections (Sections 1012 and 1016) define the "adjusted basis" of property as its cost, with adjustments for various capital account transactions not here rele-

vant. Since petitioners admittedly had a zero basis in their timber, they are not entitled to any casualty loss deduction even though the fair market value of their timber at the time of the loss and the decrease in fair market value as a result of the loss exceeded their adjusted basis. See Treasury Regulations on Income, Sections 1.165-1(c)(1) and 1.165-7(b)(1), Appendix, *infra*, p. 7; *Helvering* v. *Owens*, 305 U.S. 468; *Alcoma Ass'n* v. *United States*, 239 F. 2d 365 (C.A. 5); *Carloate Industries, Inc.* v. *United States*, 354 F. 2d 814 (C.A. 5); *Rosenthal* v. *Commissioner*, 416 F. 2d 491 (C.A. 2). As the Second Circuit explained in *Rosenthal* v. *Commissioner*, *supra* at 497:

> Manifestly, the purpose of Sec. 165 is not to allow the taxpayer a full deduction for every loss in market value his property suffers by reason of a casualty. The permissible deduction for such loss is always limited to the taxpayer's basis, or cost, in the property damaged. And the reason for this limitation is clear. Where the taxpayer suffers a loss from a destruction of market value greater than the cost of the property to him, that excess of value destroyed represents unrealized appreciation. And he may not claim a deduction for such loss because he has never recognized or paid a tax on the gain. In the extreme case, *where the taxpayer's basis in the property damaged is zero, and its entire market value represents unrealized appreciation, he is entitled to no deduction despite the size of the loss, large as it may be.* Consequently, taxpayers' argument that the Commissioner's result, by limiting the amount of their deduction to less than the full amount of their loss, would defeat

the purpose of § 165 is simply incorrect. [Emphasis supplied.]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 165. LOSSES.

(a) *General Rule.*—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

(b) *Amount of Deduction.*—For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

* * * *

SEC. 1011. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under section 1012 * * *), adjusted as provided in section 1016.

* * * *

SEC. 1012. BASIS OF PROPERTY—COST.

The basis of property shall be the cost of such property, except as otherwise provided * * *.

* * * *

SEC. 1016. ADJUSTMENTS TO BASIS.

(a) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(1) for expenditures, receipts, losses, or other items, properly chargeable to capital account * * *.

* * * *

Treasury Regulations on Income Tax (26 C.F.R.):

SEC. 1.165-1. LOSSES.

* * * *

(c) *Amount deductible.* (1) The amount of loss allowed as a deduction under section 165(a) shall not exceed the prescribed amount by § 1.1011-1 as the adjusted basis for determining the loss from the sale or other disposition of the property involved. * * *

* * * *

SEC. 1.165-7. CASUALTY LOSSES.

* * * *

(b) *Amount deductible.* (1) *General rule.* In the case of any casualty loss * * *, the amount of loss to be taken into account for purposes of section 165(a) shall be the lesser of either—

(i) * * * [The loss in fair market value]; or (ii) The amount of adjusted basis prescribed in § 1.1011-1 for determining the loss from the sale or other disposition of the property involved.

* * * *

CERTIORARI DENIED

N.C.R.